IFRS Accounting

Staff paper

Agenda reference: 6

Capital Markets Advisory Committee

Global Preparers Forum

Date **14 June 2024**

Project **Power Purchase Agreements**

Topic **Exposure Draft *Contracts for Renewable Electricity***

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Purpose of this session

1. To provide an overview of:
   - the IASB's objectives in publishing the Exposure Draft;
   - the proposed amendments to IFRS 9; and
   - the proposed disclosure requirements in IFRS 7 by way of an illustrative example.
2. To ask CMAC and GPF members their views on questions listed on slides 5–6

Information for CMAC and GPF members

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Questions for CMAC and GPF members

Questions for CMAC members

1	In your view, would the proposed disclosure requirements provide information that would be useful to your analysis and decision-making? Do you have any alternative suggestions for the proposed disclosures for the IASB to consider?
2	Is there any useful information about contracts for renewable electricity that you believe is not currently captured by the proposed disclosure requirements? How would you use such information?

Questions for GPF members

1	In your view, would the proposed requirements address the accounting challenges arising from applying the requirements in IFRS 9? If not, why not and what alternatives would you suggest?
2	Do you foresee any operational challenges in providing the proposed disclosures? If so, what are the reasons and do you have any alternative suggestions to provide useful information to users of financial statements?
3	In your view, how long would you need to implement the proposed amendments and what would be an appropriate effective date for the proposed amendments?

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Background information

Origin of the project (1/2)

- The IFRS Interpretations Committee received a request about how an entity would apply paragraph 2.4 of IFRS 9 *Financial Instruments* to contracts to buy and take delivery of electricity produced from nature-dependent sources, for example physical PPAs[1].
- The request said entities experience application challenges when applying the requirements in IFRS 9 to these contracts. These challenges arise due to the combination of:
  (a) the characteristics of the sources of renewable electricity production and the design and operation of the market in which the electricity is sold; and
  (b) the ‘pay-as-produced' features of these long-term contracts.
- The Interpretations Committee referred the matter to the IASB to consider whether narrow-scope standard-setting would be appropriate.

[1] See Appendix 1 for a description of physical PPAs

Origin of the project (2/2)

- The IASB consulted with various stakeholders to understand the nature of the application questions and the type of contracts that give rise to those challenges

- Stakeholders told the IASB that:
  - applying the requirements in IFRS 9 to PPAs sometimes provided less useful information to users of financial statements;
  - a timely solution was needed because of an expected increase in the use of PPAs; and
  - any proposed solution would need to consider both physical PPAs and virtual PPAs.[1]

- Consequently, the IASB decided to add a maintenance project to the work plan to explore narrow-scope standard-setting.

[1] See Appendix 1 for a description of virtual PPAs

Project timeline:

Jun 2023

IFRIC meeting

- Initial request received by the IFRS Interpretations Committee

Jul 2023

IASB meeting

- The IASB decided to explore narrow-scope standard setting for PPAs and added a maintenance project to the work plan

H2 2023

Research and outreach

- Outreach and informal consultation phase with over 28 stakeholders globally
- The IASB decided to proceed with narrow-scope standard-setting and explore potential solutions

Q1 2024

IASB meeting

- Presentation of research and outreach to IASB members
- Development of detailed proposal to amend IFRS 9 *Financial Instruments*

May 2024

IASB meeting

- Publication of the ED *Contracts for Renewable Electricity*

Nov 2024

Final Amendments

- Publication planned for Nov 2024 subject to feedback and redeliberations

Overview

The IASB's objectives

The IASB is aiming to provide a timely solution that:

- provides more useful information to users of financial statements;
- includes both physical and virtual PPAs; and
- limit the risk of unintended consequences.

What is the IASB proposing?

To achieve these objectives, IASB proposes:

- specified characteristics to define the scope of contracts for renewable electricity to which the amendments apply;
- amendments to the 'own-use' requirements;
- amendments to the hedge accounting requirements; and
- additional disclosure requirements for all contracts with the scope of the ED.

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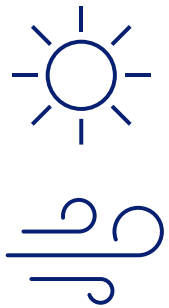
Proposed amendments

Contracts for renewable electricity:

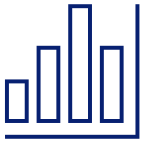
- are typically based on proportion of the volume of electricity produced by a referenced production facility (ie a specified wind or solar farm);
- specify a fixed price for electricity produced;
- can be either gross- or net-settled; and
- often include renewable electricity certificates (RECs) or similar attributes.

Scope of proposals: Contracts for renewable electricity that have **both** characteristics:

1. source for production of electricity is nature-dependent => supply cannot be guaranteed; and

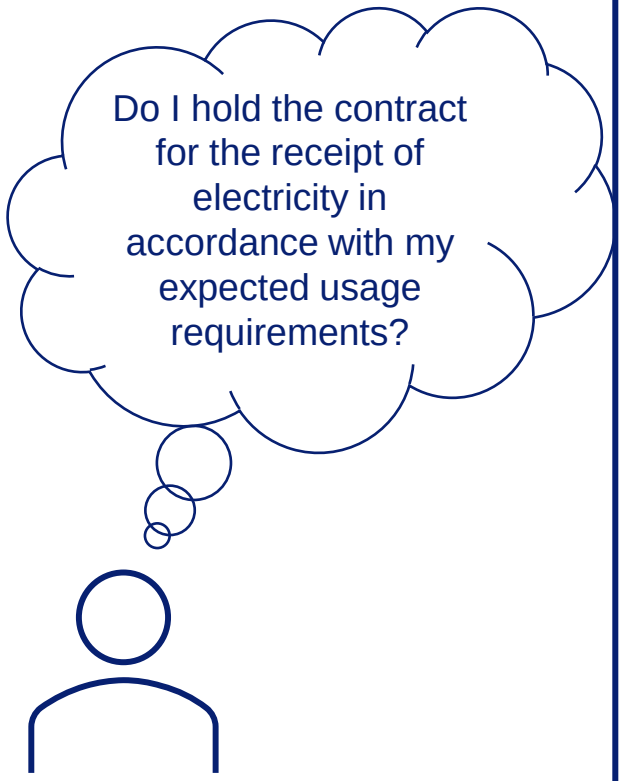


2. the purchaser is exposed to substantially all volume risk through ‘pay-as-produced’ features.



‘Own-use’ requirements (paragraph 2.4 of IFRS 9)

To enable the forced sales that a company has no control over to not affect the own-use assessment.



For contracts to buy and take delivery of renewable electricity (ie physical PPAs), the **purchaser** considers at inception and at each reporting date the:

1. purpose, design and structure of contract, including volumes expected to be delivered.
2. whether past and expected sales of unused electricity shortly after delivery occur because of:
   - the company’s exposure to volume risk (pay-as-produced features);
   - the design and operation of the electricity market in which the electricity is traded; and
   - the company expects to purchase at least an equivalent volume of electricity within reasonable time after the sale.

Hedge accounting requirements

To enable the hedge accounting relationship to not be affected by volume uncertainty

If a contract for renewable electricity is used as a hedging instrument in a cash flow hedging relationship, the proposals permit the:

1 Designation as a hedged item

- a variable nominal volume of forecasted sales or purchases

if, and only if that variable amount:

- relates to the variable volume of the hedging instrument; and
- is highly probable.#

2 Measurement of the hedged item

- using the volume assumptions as those used for measuring the hedging instrument;
- however, all other assumptions reflect the nature and characteristics of the hedged item

forecasted sales are not required to be highly probable if the hedging instrument relates to a proportion of the total future renewable electricity sales from the production facility as referenced in the contract for renewable electricity

Disclosure requirements

To enable investors to understand the effect on financial performance and future cash flows

Disclosures by both **sellers** and **purchasers** for all contracts for renewable electricity within the scope of the proposals:

1. the terms and conditions of the contracts.
2. the volume of renewable electricity a seller expects to sell, or a purchaser expects to purchase, over the remaining duration of the contracts; or the fair value of the contracts at the reporting date within specified time bands.
3. the proportion of renewable electricity covered by the contracts to the total electricity sold or purchased for the reporting period.
4. purchasers need to disclose the total net volume of electricity purchased, the average market price per unit of electricity in the relevant spot market and if the total net volume multiplied by the average market price differs substantially from the actual total cost, a qualitative explanation of the key reasons for this difference.

Illustrative example—disclosure requirements (1/3)

Proposed items of information are referenced with blue icons

NOTE X—CONTRACTS FOR RENEWABLE ELECTRICITY

Contracts accounted for as executory contracts

The company is party to pay-as-produced contracts to buy and take delivery of electricity produced from referenced wind farms. The other terms and conditions of these contracts include […] (1)

The company expects to purchase the following volume of electricity over the remaining duration of these contracts:[1]	less than 1 year	1–5 years	more than 5 years
	X MWh	X MWh	X MWh

(2)

The company calculated its expected purchases using the 70% probability of the expected volume of electricity to be produced by the referenced production facilities.

[1] As an alternative, the company is permitted to provide the fair value of the contracts at the reporting date, accompanied by the information required by paragraphs 93(g)–(h) of IFRS 13 *Fair Value Measurement*. This may be the case if the company already measures other contracts at fair value.

Illustrative example—disclosure requirements (2/3)

Proposed items of information are referenced with blue icons

NOTE X—CONTRACTS FOR RENEWABLE ELECTRICITY

Contracts accounted for as derivatives

The company is also party to pay-as-produced contracts that require net settlement of the difference between the prevailing market price and the contractually agreed price for the volume of electricity produced from referenced solar farms. The other terms and conditions of these contracts include […] 1

The company designated these contracts as hedging instruments in cash flow hedging relationships. More information is included in Note Y—Hedge Accounting. Information about the fair value of these contracts are included in Note X—Fair Value Measurement.[1]

[1] The IASB does not require a company to duplicate information it provides applying existing requirements in IFRS Accounting Standards.

Illustrative example—disclosure requirements (3/3)

Proposed items of information are referenced with blue icons

NOTE X—CONTRACTS FOR RENEWABLE ELECTRICITY

Volume of electricity covered by the contracts

The company receives Renewable Electricity Certificates for the volume of electricity produced that is covered by the contracts. The volume covered by the contracts for this reporting period represents X% of the company's total net volume of electricity purchases. 3

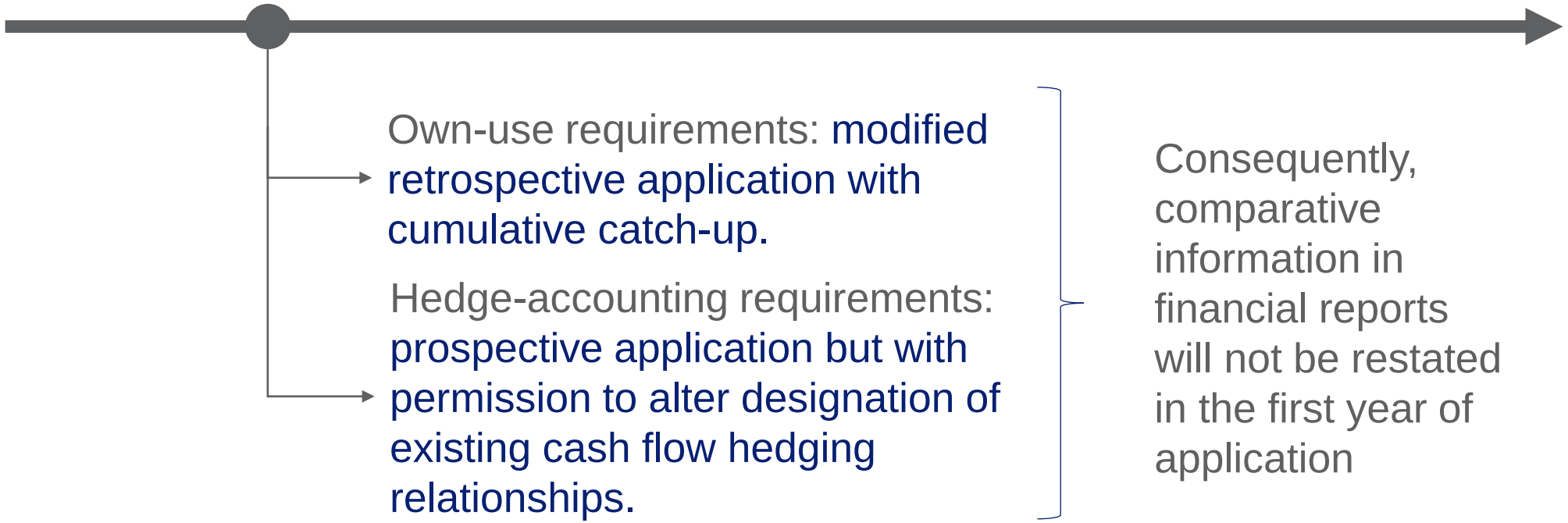
The company's total net volume of electricity purchases for the period amounted to X MWh. The average market price per unit of electricity for the period amounted to CUX. [The company benefited from fixing the price for electricity under these contracts. Because the company's demand cannot be matched to production, the entity was exposed to residual price volatility from selling and repurchasing electricity at different times.] [1, 2] 4

1 The items of information illustrated in this paragraph is required only for a company that is a purchaser under the contracts.

2 The information in the last sentence within square brackets illustrates qualitative reasons for why the net volume of purchases multiplied by the average market price substantially differs from the actual total electricity cost for incurred by the company for the reporting period.

Transition requirements

To enable companies to apply the amendments as soon as issued



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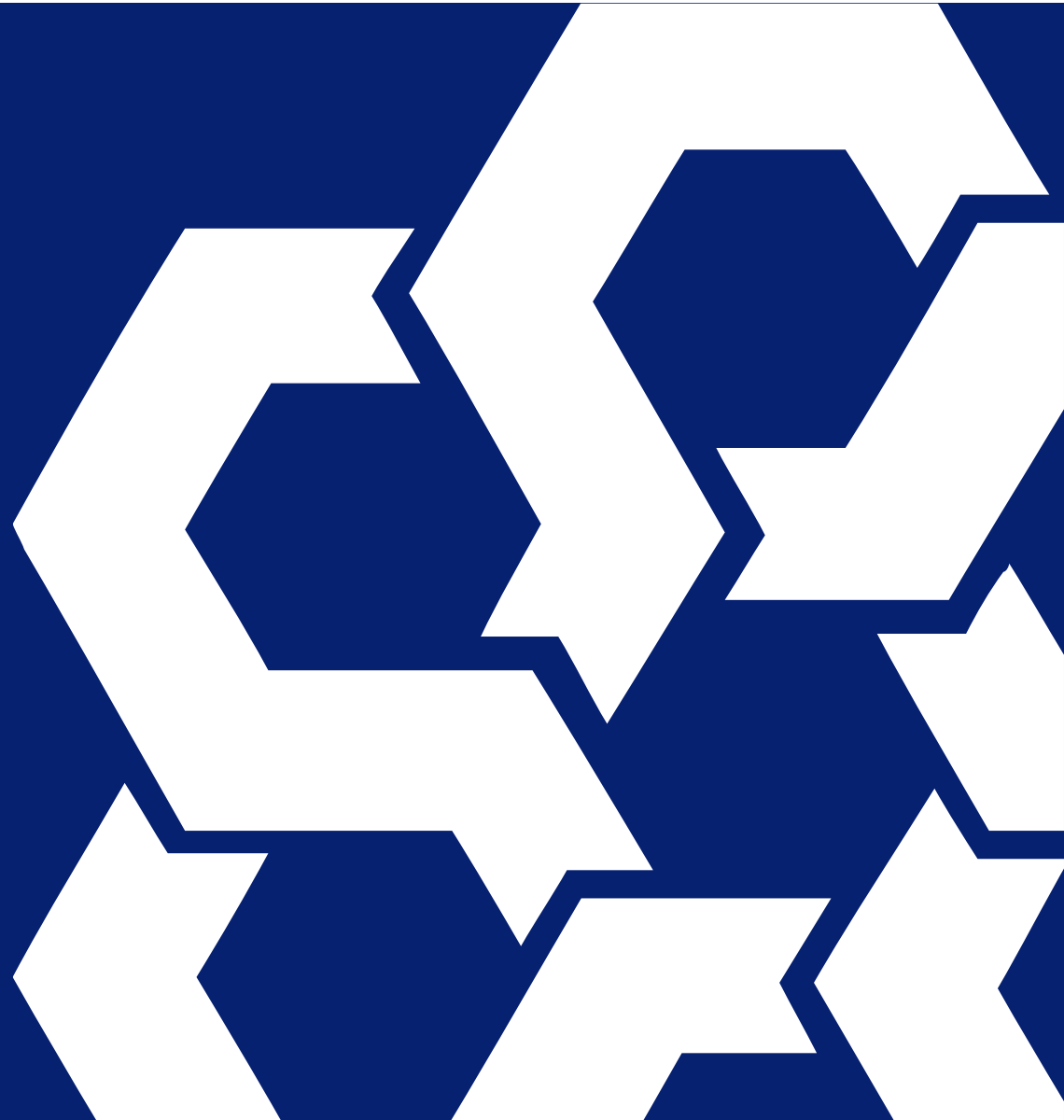
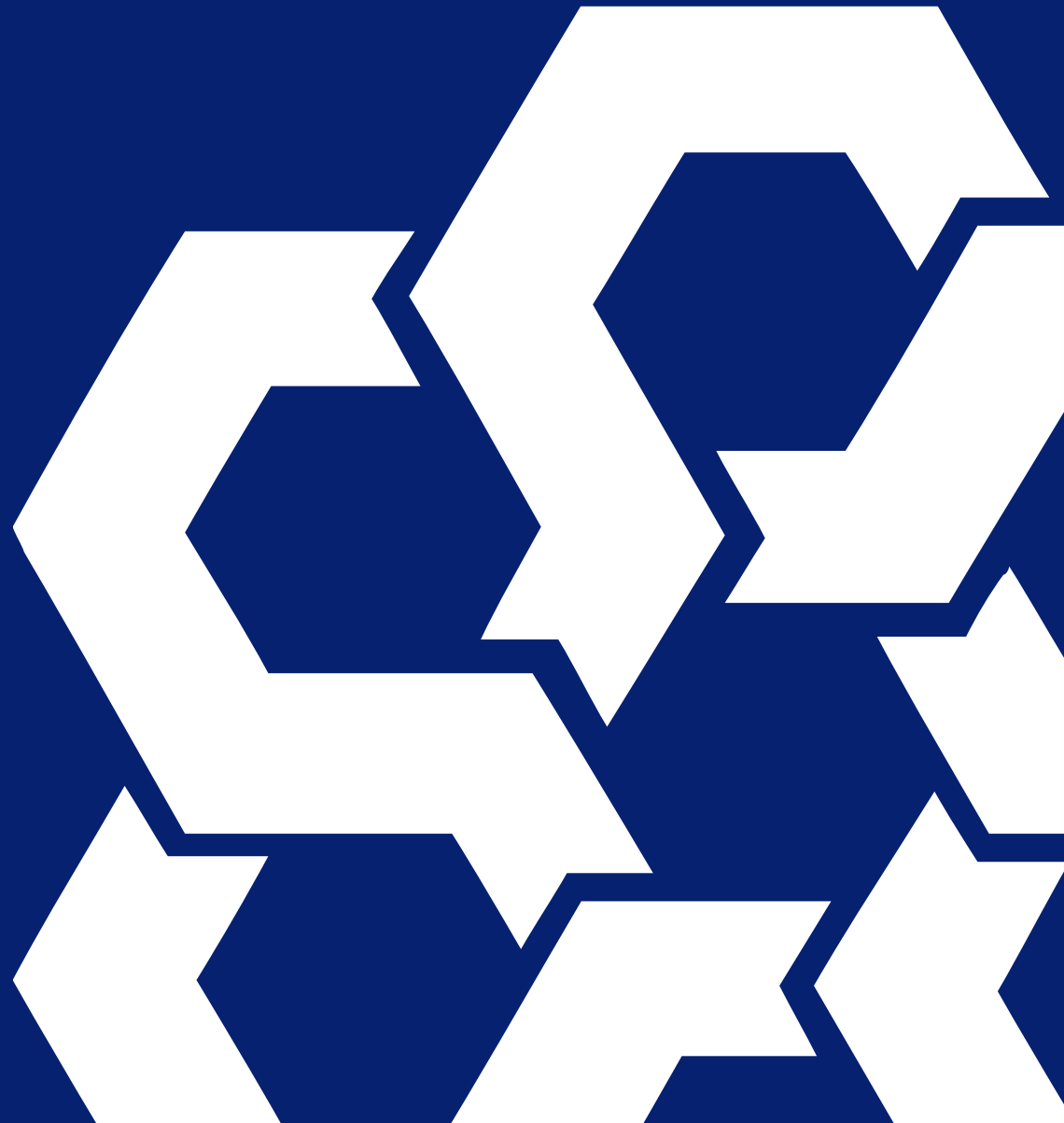
Thank you



Appendix —Contracts for Renewable Electricity: Overview



Overview

Contracts for renewable electricity are often structured as PPAs are grouped as either physical PPAs or virtual PPAs, each with their own accounting implications.

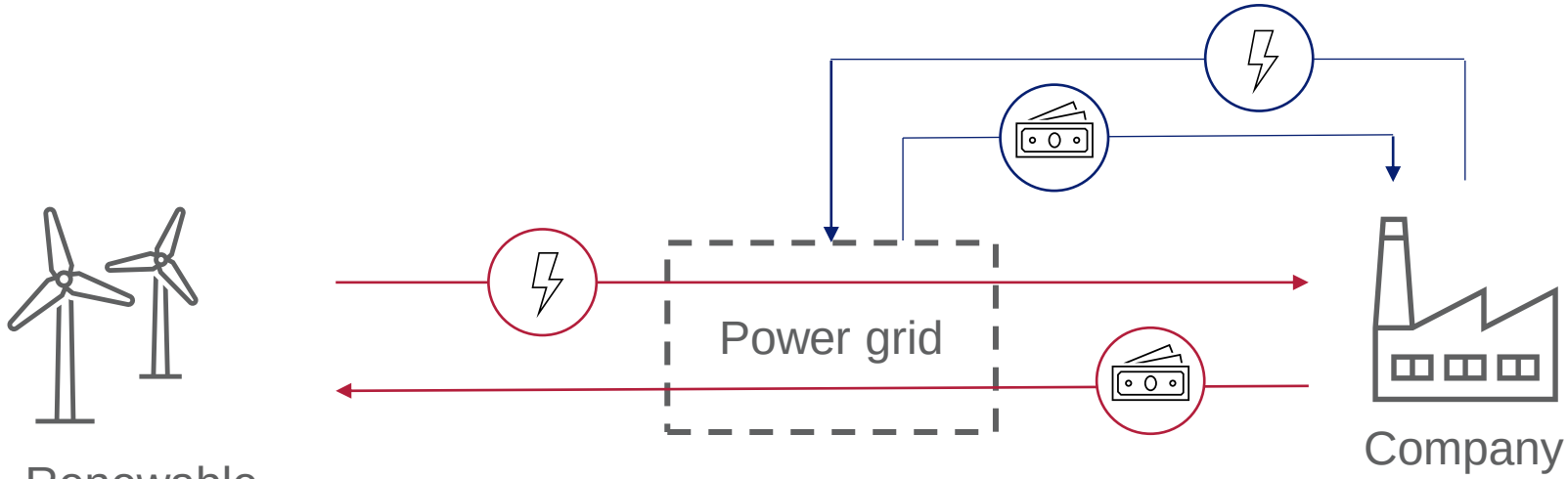
Physical PPAs

Physical PPAs involve a contractual obligation for the buyer to take delivery of and pay for the amount of electricity produced from a referenced production facility. Electricity purchased under a physical PPA must be used within a short period of time or sold back to the market. The issue is whether these contracts qualify for the “own use” exception in IFRS 9, which would allow them to be accounted for as a normal purchase (‘executory contract’).

Virtual PPAs

Virtual PPAs differ from physical PPAs as they do not contain an obligation for the buyer to take delivery of electricity. Instead, the buyer and the supplier settle the difference between the contractually specified price and the prevailing market price. Virtual PPAs meet the definition of a derivative but the current hedge accounting requirements do not enable an entity to fully reflect the companies’ risk management strategies.

Physical power purchase agreements



Renewable power producer

1

Physical PPA

The producer delivers power to the company by crediting their account with the grid.

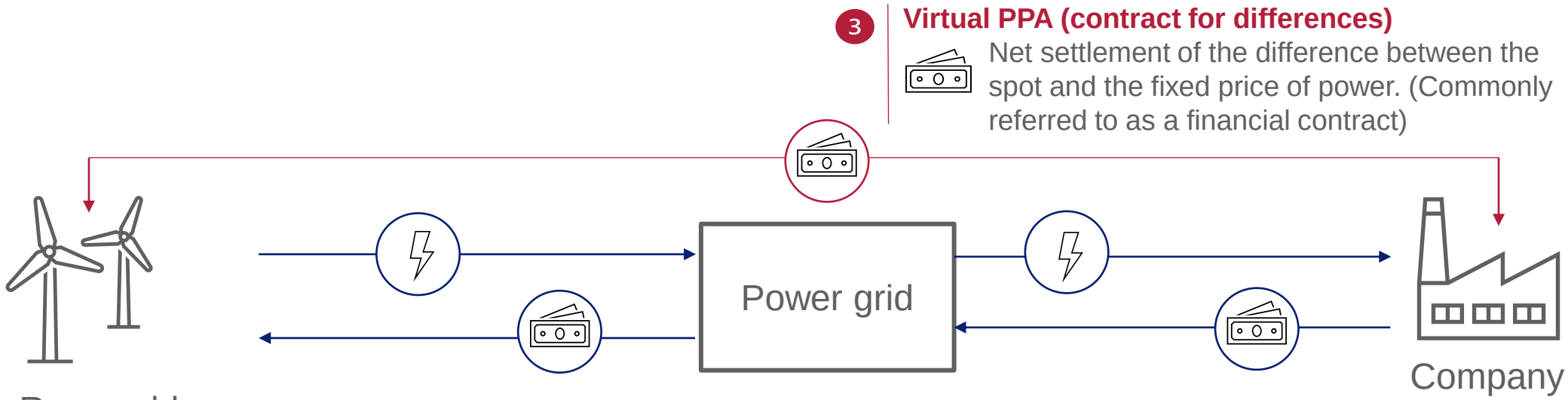
The company pays a fixed price for the power delivered.

2

The company sells any unused power to the grid

The company receives the spot price for the power sold

Virtual power purchase agreements



3 Virtual PPA (contract for differences)

Net settlement of the difference between the spot and the fixed price of power. (Commonly referred to as a financial contract)

1

The producer delivers power to the grid.

The producer receives the spot price for the power delivered

2

The company buys power from the grid.

The company pays the spot price for the power delivered

Some variations on physical or virtual PPAs

Short-Term PPAs	These PPAs have a shorter duration compared to long-term agreements. They are often used to provide flexibility and manage energy supply or demand fluctuations in the short term.
Sleeved PPAs	A sleeved PPA involves an intermediary. The intermediary facilitates the transaction and ensures the delivery of electricity from the renewable energy generator to the company. Sleeved PPAs can be useful when the company has specific requirements or limitations that prevent a direct agreement with the renewable energy generator.
Offsite PPAs	Agreements in which the renewable energy generator and the company are located in different geographical locations. The electricity generated by the renewable energy generator is fed into the grid, and the company receives financial benefits or RECs (or GOs) based on the agreed-upon terms.

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